STATE OF RHODE ISLAND

BEFORE THE

PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE PETITION	)	Docket No. 3800
OF WOONSOCKET WATER DIVISION	)	
FOR AN INCREASE IN RATES FOR	)	
WATER SERVICE	)	

DIRECT TESTIMONY OF

ANDREA C. CRANE

REGARDING REVENUE REQUIREMENTS

ON BEHALF OF

THE DIVISION OF PUBLIC UTILITIES AND CARRIERS

March 23, 2007

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is P.O. Box 810, One North Main Street, Georgetown, Connecticut 06829.

Q. By whom are you employed and in what capacity?

A. I am Vice President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various financial studies relating to utility rates and regulatory policy.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in approximately 250 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, West Virginia and the District of Columbia. These proceedings involved water, wastewater, gas, electric, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony is included in Appendix A. I have also been engaged to provide testimony as an expert witness in several civil proceedings.

Q. What is your educational background?

A. I received a Masters degree in Business Administration, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

Q. Do you have any additional relevant experience?

A. Yes, from January 1991 until January 1998, I served as Vice Chairman of the Water Pollution Control Commission in Redding, Connecticut. This Commission was charged with designing, constructing, and operating a sewage collection and treatment facility for the Town of Redding.

II. <u>PURPOSE OF TESTIMONY</u>

Q. What is the purpose of your testimony?

A. The Columbia Group, Inc. was engaged by The Division of Public Utilities and Carriers

("Division") to review the recent base rate filing by Woonsocket Water Division ("WWD" or "Company") and to provide revenue requirement recommendations to the Public Utilities Commission ("PUC" or "Commission"). In developing my revenue requirement recommendations, I reviewed WWD's testimony and exhibits and the responses to data requests propounded upon WWD by the Division and the Commission. I also had informal discussions with WWD representatives in order to clarify certain issues.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning WWD's revenue requirement?

A. Based on my review, my conclusions and recommendations are as follows:

1. Based on the rate year ending June 30, 2008, WWD has pro forma operating revenue at present rates of $7,266,691 (see Schedule ACC-1).
2. WWD has pro forma costs, including pro forma debt service costs, of $8,175,391.
3. Based on these determinations, a rate increase of $908,700 is appropriate. This recommendation results in an increase of approximately 12.5% of total pro forma revenues at present rates. My recommendation is approximately 53% of the rate increase of $1,720,064 that is being requested by WWD.

IV. DISCUSSION OF THE ISSUES

A. Introduction

Q. Please summarize WWD's request for rate relief in this case.

A. WWD is requesting a rate increase of $1,720,064 or 24.92% over its claimed level of pro forma revenue at present rates. WWD's request is based on a test year ending June 30, 2006 and on a rate year ending June 30, 2008. The requested increase of $1,720,064 is composed of the following items:

Test Year Loss	$326,986
IFR	$444,570
Debt Service	$229,136
Personnel	$250,950
Health Care	$179,196
Operating Reserve	$127,440
Chemicals	$82,116
Engineering	$60,084
Maintenance-Road/Walks	$53,722
Other Insurance	$51,774
Rate Case	$51,364
Light and Power	$50,828
Property and Fire Taxes	$10,903
Wholesale Sales	($199,066)
Total	$1,720,063

As demonstrated above, this case is being driven primarily by the Company's increased debt service and personnel costs, its request for an increase to its Infrastructure Rehabilitation Plan ("IFR") funding, and its under-recovery during the test year.

Q. What is the reason for the test year under-recovery?

A. According to WWD, at least some of this loss resulted from lower than anticipated sales. According to the response to DIV 1-3, test year sales were significantly below fiscal year 2005 levels. The Company sold approximately 158.8 million cubic feet of water in fiscal year 2006, approximately 27.7 million cubic feet or 13.7% less than year earlier levels.

Q. Did WWD actually record a loss during the test year?

A. No, it did not. The above claim showing a test year loss of $326,986 is somewhat misleading. That claim is based on normalized pro forma test year revenues and costs. The claimed loss does not reflect substantial grant revenues that the Company received during the test year. In addition, the test year loss includes adjustments to various reserve accounts to reflect the funding amounts approved by the Commission, rather than the amounts actually booked to these cost categories in the test year. According to Schedule DGB-1, WWD actually reported net income of $1,121,291 for the test year in this case, instead of the net loss that serves as the starting point in the Company's filing.

B. <u>Pro Forma Operating Revenue</u>

Q. How did WWD develop its pro forma revenue claim?

A. In order to develop its pro forma revenue claim, WWD generally used actual test year revenues from water sales. The Company did make an adjustment to include an additional $199,006 of revenue relating to incremental wholesale sales to the Town of North Smithfield ("Town"). This incremental revenue reflects an Intermunicipal Agreement with the Town by which WWD has agreed to allocate 400,000 gallons per day of its treatment plant capacity to the Town. The Company's claim in this case is based on actual sales of only about 170,000 gallons per day to the Town projected for the rate year.

Q. How should pro forma revenues for a water utility be determined?

A. In order to determine pro forma revenue, it is common to first examine metered consumption, i.e. sales per customer. Consumption fluctuates from year-to-year due to a variety of factors. The most significant factors that influence the variations in annual water consumption from year-to-year are temperature and rainfall. Given that metered consumption fluctuates, it is common to use an average consumption over a period of time to determine a "normalized" level of consumption for ratemaking purposes.

I examined the Company's residential consumption figures during the past five years, as shown below:[1]

1 Data derived from the responses to DIV 1-16 and DIV 1-17.

Residential Consumption	Total Sales (Ccfs)	Customers	Average Consumption
FY 2006	1,098,109	8,229	133.4
FY 2005	1,264,134	8,292	152.5
FY 2004	1,215,146	8,309	146.2
FY 2003	1,219,298	8,321	146.5
FY 2002	1,164,455	8,364	139.2
Three Yr. Average			144.1
Five Year Average			143.6

I next examined commercial consumption over the same period, as shown below:

Commercial Consumption	Total Sales (Ccfs)	Customers	Average Consumption
FY 2006	471,852	1,114	423.6
FY 2005	554,598	1,118	496.1
FY 2004	568,249	1,121	506.9
FY 2003	617,981	1,126	548.8
FY 2002	626,986	1,110	564.8
Three Yr. Average			475.5
Five Year Average			508.0

I also examined total WWD sales. Total sales increased from fiscal year 2002 to fiscal year 2003, declined in fiscal year 2004, increased in fiscal year 2005, and declined in fiscal year 2006.

FY 2006	1,588,029 Ccfs
FY 2005	1,839,549
FY 2004	1,803,674
FY 2003	1,859,967
FY 2002	1,812,545
Three Yr. Average	1,743,751
Five Year Average	1,780,753

Q. Does this represent a pattern of declining sales as alleged by WWD?

A. No, it does not. The data suggests that residential sales have been relatively stable on a per customer basis, with very little difference between the three-year average and the five-year average. There has been some decline in the total number of residential customers over the past five years. With regard to commercial sales, there has been a decline in usage per customer as well as in the number of customers, but WWD stated in response to COMM 1-15 that "[i]t is likely that the decrease in water sales to commercial customers has stabilized." More importantly, total sales have been relatively stable over the past five years, except for the decrease in fiscal year 2006.

Q. What do you recommend?

A. Based on all of the information available to me at this time, I am recommending an adjustment to WWD's pro forma revenue to reflect an average of total sales over the past two years. This adjustment results in pro forma sales of 1,713,789 Ccfs. My recommended adjustment provides a balance between using the actual test year sales, which were unusually low, and using a longer-term average that may too heavily discount the actual test year results. My adjustment to WWD's pro forma revenue claim is shown in Schedule ACC-2.

Q. In quantifying your adjustment, did you consider incremental variable costs associated with increased sales?

A. Yes, I did. As shown in Schedule ACC-2, I first calculated the total additional pro forma revenue that would be generated by my recommended sales adjustment. I then reduced this revenue to reflect the fact that the Company will incur additional costs for power and chemicals as a result of increased sales. In order to quantify these incremental expenses, I calculated the incremental power and chemical costs per Ccf of water sales. This resulted in incremental costs of 35.1 cents per Ccf. I then multiplied my recommended sales adjustment, in Ccfs, by the 35.1 cents per Ccf to determine the total incremental expenses associated with these incremental sales. My pro forma operating revenue adjustment was then reduced by these incremental expenses.

C. Light and Power Expenses

Q. Please provide a brief background of the Company's claim for light and power costs in its last base rate case.

A. One of the issues in the Company's last base rate case was its agreement for energy supply with Constellation NewEnergy, Inc. ("CNE"). The City of Woonsocket ("City") had a contract for the supply of electric power with Select Energy that expired on December 31, 2003. The City solicited bids for competitive electric supply in November 2003. The City received two bids, one from CNE and one from TransCanada Power Marketing, Ltd ("TransCanada"). CNE offered a three-year or five-year contract. TransCanada offered a three-year or four-year contract.

The City chose to sign a contract with CNE, even though the contract rates offered by CNE were higher than the rates offered by TransCanada. The contract that was signed with CNE had a significant price differential between the water and wastewater facilities, to the benefit of the wastewater facility. Documentation provided by the City in the last case suggested that the fact that CNE was willing to offer a five-year term may have been responsible for the decision to choose the more expensive bid from CNE rather than the TransCanada bid.

In the last case, I recommended that the Commission use a pro forma average City electric supply rate to set water rates in that proceeding. I made that recommendation in order to prevent the subsidization of the wastewater utility by water utility customers. In its order in the last case, the Commission found that WWD should reflect a supply rate that was no higher than the rate that it could have received had it executed a contract with TransCanada.

Q. Does the Company still have a contract with CNE for the provision of energy supply?

A. No, it does not. Apparently, CNE did not perform under the contract. As a result of non-performance, CNE and WWD entered into an agreement whereby CNE agreed to pay a settlement to WWD of 0.9 cent per kwh through 2007. WWD subsequently entered into a contract for energy supply with TransCanada. TransCanada is charging a rate of 6.6 cents per kwh for the term of the contract, from February 2005 through December 2009. This is considerably higher than the rate originally bid by TransCanada.

Q. How did the Company determine its pro forma claim for light and power in this case?

A. The Company has based its claim on its actual test year kwh usage. It has priced this usage at the contractual TransCanada rate of 6.6 cents per kwh. It has also included a charge of 1.2 cents per kwh relating to the Forward Capacity Market ("FCM") Charge implemented by FERC on January 1, 2007. The 1.2 cents per kwh is the "upper" end of the range estimated for the FCM by the Eisenhardt Group, WWD's consultants. The FCM is treated as a direct pass-through under the TransCanada contract. In developing its pro forma claim for light and power, WWD did not include the credit of 0.9 cents per kwh from CNE as an offset to its rate year costs. As mentioned previously, that credit is due to expire at the end of 2007.

It should be noted that the power costs claimed in this case are considerably higher than the costs that WWD would have incurred if it had entered into the TransCanada contract originally. TransCanada offered a rate of 5.5 cents per kwh for four years for all City usage. That rate was rejected, and instead the City accepted a contract with Constellation Energy that included a higher rate for the water utility, but a lower rate for the wastewater facility. As a result of WWD's apparent desire to benefit the wastewater facility over the water facility, WWD lost an opportunity to lock-in TransCanada's rate for four years.

Q. Are you recommending any adjustments to the Company's claim?

A. Yes, I am recommending two adjustments. First, I am recommending that WWD's light and power costs be based on the actual rate in place during the rate year, which in this case is fiscal year 2008. Thus, I am including the credit from CNE of 0.9 cents per kwh for the first six months of the rate year. This credit is meant to compensate ratepayers for CNE's non-performance, which would not have been an issue had WWD originally chose TransCanada, which offered the lowest water utility rate, as its electric supplier. Thus, at Schedule ACC-3, I have reduced the Company's light and power claim by 0.45 cents per kwh, which reflects a credit of 0.9 cents per kwh for one-half of the rate year.

Second, in developing its claim, WWD relied upon the FCM estimates provided by the Eisenhardt Group. These estimates were as follows:

Calendar Year	Range of FCM Capacity Charges[2]
2007	$0.0070-$0.0100 / kwh
2008	$0.0083-$0.0120 / kwh
2009	$0.0095-$0.0140 / kwh

WWD has included a cost of 1.2 cents per kwh in its revenue requirement claim. I am recommending that the Commission utilize a rate of 0.93 cents per kwh. This is the average estimated rate during the rate year. I developed this rate by taking a midpoint of WWD's estimates for calendar years 2007 and 2008.

Q. What is the impact of the two light and power adjustments that you are recommending?

A. My adjustments reduce the Company's pro forma light and power expense claim by a total of $16,537, as shown in Schedule ACC-3.

D. Health Care Costs

Q. How did the Company develop its health care cost claim in this case?

A. The Company first calculated the difference between its actual test year costs and its

2 Response to COMM-23. Note that this response apparently contains a typographical error with regard to the

interim rate year budget. WWD determined that the increase from the test year to the interim year was 22.0%.[3] The Company then increased its interim year budgeted costs by this percentage increase in order to develop its rate year claim.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am. While I realize that health care costs have risen significantly, and in fact continue to rise, I do not believe that the Company has adequately supported its claim. The interim year increase used by the Company is significantly greater than the increase in any of the prior five years, as shown below:

Year	Costs	Increase
Interim Year	$448,743	22.0%
FY 2006	$367,822	0.0%
FY 2005	$367,822	10.0%
FY 2004	$334,384	11.0%
FY 2003	$301,247	
Av. Annual Inc.		10.5%

WWD appears to be self-insured for medical insurance costs, since the Company stated in response to DIV 1-33 that it "pays for medical insurance on claims basis." In

bottom end of the ranges for 2008 and 2009.

that response, WWD stated that it pays a "working rate to Blue Cross which year end there is a true up adjustment." In DIV 2-14, WWD stated that the working rate was developed by Blue Cross based on a proprietary formula that is not provided to the City of Woonsocket. In DIV 2-15, the Company was asked to provide, for the past five years, the total amount paid by WWD for health insurance and the amount of any true-up. WWD has still not provided a response to this data request.

Q. What do you recommend?

A. I am recommending that the Commission use the average increase over the past four years to determine the pro forma amount to include in utility rates. As shown above, the average annual increase from fiscal year 2003 through the interim year has been 10.5%. Therefore, I recommend that the Commission include a pro forma medical cost adjustment of $47,188, which reflects an increase of 10.5% over the interim rate expense included in the Company's filing. My adjustment is shown in Schedule ACC-4.

It should be noted that the Company has still not provided any information regarding the true-up adjustments from Blue Cross over the past few years. At the present time, we do not know the magnitude of these adjustments, or how they are recorded by WWD. If the Company provides additional details on these adjustments during the litigation phase of this case, I may adjust my recommendation further, as appropriate.

3 On Schedule WEE-8, the Company states that the increase is 21.9%. However, the actual increase is 22.0%.

E. Engineering Services

Q. Did WWD make an adjustment in this case relating to engineering services?

A. Yes, it did. As shown on Schedule WEE-3, WWD included an adjustment of $60,084. According to the testimony of Mr. Edge at page 11, "[t]his adjustment is for the engineering work on the system that is required per the recommendations of WWD's consultants, CDM (e.g. flushing)."

Q. Did WWD provide any further description of this program or why the costs are being requested in this case?

A. No, it did not. No further information was provided in the Company's testimony. I did attempt to solicit additional information during the discovery process. In DIV 1-45, I asked the Company to provide supporting documentation and workpapers for this adjustment. The Company responded by referring me to the 1999 CDM Report. In addition, WWD stated in this response that it was important to periodically flush the system and that the proposed systematic flushing program would remove more sediment than the random flushing program that had been done in the past.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending that the $60,084 cost included in WWD's claim be disallowed, for two reasons. While I support flushing programs undertaken by water utilities, any cost claim for such programs must be supported by adequate cost documentation. In this case, WWD is relying upon a report developed eight years ago. If WWD proposes to raise water rates to pay for a systematic flushing program model, it should be required to provide better and more recent documentation, outlining the specifics of the program, describing how the cost estimates were developed, and demonstrating that the costs are reasonable given the parameters of the proposed program. Such documentation was not provided by WWD in this case.

In addition, the Company's proposed Infrastructure Rehabilitation Program ("IFR") costs already include $95,000 for flushing studies, as shown in WEE-10. Moreover, these studies are projected to be undertaken in fiscal year 2007 and therefore funding for these studies is already included in the Company's current fiscal year IFR projections. Thus, there is no reason to provide for additional funding in later years through a separate expense adjustment. For both of these reasons, I am recommending that the Company's claim for a $60,084 adjustment relating to engineering costs be denied. My adjustment is shown in Schedule ACC-5.

F. <u>Rate Case Costs</u>

Q. How did the Company determine its rate case expense claim in this case?

A. WWD has a restricted rate case reserve account that has been funded at $30,000 annually. The Company is requesting an increase in this funding level to $81,364. Mr. Edge estimates costs of the current case to be approximately $146,728, which he proposes to amortize over a two-year period.[4] In addition, he has included additional costs of $16,000, relating to expenses covered by the general fund, that he also proposes to amortize over two years. Thus, WWD is requesting total rate case costs of $162,728, amortized over two years, or annual funding for $81,364.

Q. Why is the Company's claim so much higher than the amount requested in WWD's last rate case?

A. There are several reasons for this increase. In the last case, WWD was requesting rate case costs of $120,000 amortized over three years. Therefore, not only were the proposed rate case costs requested in the prior case lower than the costs being requested in this case, but the amortization period was longer. The amortization period selected by WWD has a significant impact on the actual annual rate case expense claim. In addition, in the last case, the rate case reserve account had a balance of $57,105 at the end of the 2004 fiscal year. Accordingly, there were already some funds available to offset the projected rate case expenses in the prior case.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending one adjustment. Specifically, I am recommending that the Company's claim for recovery of $16,000 in costs covered by the general fund be disallowed.

4 Schedule WEE-11.

Q. What is the basis for your recommendation?

A. The establishment of a rate case reserve account did not provide WWD with the right to retroactively request reimbursement for all amounts spent. Rather, the rate case reserve was established in order to ensure that amounts provided specifically for rate case costs would in fact be used for that purpose, and no other. WWD's proposal to recover $16,000 in general fund reimbursements, in addition to recovering its full costs for this rate case, constitutes retroactive ratemaking and should be disallowed.

Q. Are you recommending any adjustment to the costs being claimed for the current case or to the amortization period proposed by WWD?

A. No, I am not. While the rate case claim of $146,728 constitutes a significant increase over the amount claimed in the last case, I am not recommending any adjustments to WWD's claim. I have reviewed the components of this claim shown on Schedule WEE-11 and these components appear to be in the range of reasonableness. In addition, given WWD's plans to build a new treatment facility, I believe that the use of a two-year amortization period is realistic. Therefore, I am not recommending any adjustment to WWD's cost claim or amortization period associated with the current case.

Q. Do you have any further comments regarding WWD's rate case cost claim?

A. Yes, I do. According to the response to DIV 2-11, the Company's legal bills for rate case services totaled over $59,000 through the end of December 2006. This appears very high, given that WWD has estimated total legal costs of $75,000 and given the fact that the hearing or briefing stages of a rate case tend to require more legal effort than the earlier stages. In addition, WWD began incurring legal costs for this case in October 2005, more than fourteen months before the filing of the case. Another concern I have is that the invoices for legal services provided in response to DIV 2-11 do not contain any description of the work performed, the hours spent on the client's behalf, or the hourly rates being charged for legal services. This is very unusual. Lawyers generally provide a very detailed statement of the work performed, time spent, and hourly rates. Thus, even though I have the invoices for legal services, I am unable to verify that the costs charged to the rate case were in fact related to the provision of necessary rate case services. Nor am I able to verify the reasonableness of the hourly rates being charged for legal services.

Q. What do you recommend?

A. As previously stated, the overall costs of the rate case being claimed by WWD of $146,728 appear reasonable, even though these costs represent a significant increase over the costs requested for the prior case. Therefore, I am not recommending any adjustment to the Company's claim. However, I would oppose any attempt by WWD to revise its claim, which appears possible given the significant legal fees incurred to date.

In addition, I recommend that in the future, WWD be required to support its rate case legal fees with invoices containing a description of the work performed, the hours spent on the client's behalf, and the applicable billing rates. The legal invoices submitted in the response to DIV 2-11 do not provide the Commission with sufficient detail to verify the reasonableness of charges from WWD's legal counsel in this case.

G. Infrastructure Rehabilitation Program

Q. Please describe WWD's claim for funding of the IFR.

A. In the last base rate case, an IFR funding level of $1,755,000 was approved by the Commission. In this case, WWD is requesting an increase in IFR funding to $2,200,000, an increase of $445,000 or over 25%. The Company's planned IFR expenditures are shown in Schedule WEE-10. As demonstrated therein, the majority of the rate year IFR program relates to distribution system projects. According the testimony of Mr. Edge, the entire distribution system rehabilitation project is expected to take approximately 30 years to complete.

Q. Are you recommending any adjustments to the Company's claim?

A. Yes, I am recommending two adjustments. First, I am recommending that financing costs associated with $1 million in new debt for the treatment plant be eliminated from the IFR. Second, I am recommending that the remaining requested increase in IFR funding be reduced by 50%.

Q. Please explain your first adjustment.

A. As shown on Schedule WEE-10, Mr. Edge included $50,000 of financing costs on $1 million of new bonds related to preliminary work on the new treatment plant. As explained on page 4 of Ms. Gurghigian's testimony, "There is no immediate impact on rates from the proposed $ 1.0 million borrowing. The debt service on the new bonds will be paid from current IFR funds until completion of the borrowing for new Water Treatment Plant...." However, in addition to including this first year of financing costs in the IFR, Mr. Edge also included $42,050 relating to the same borrowing in his debt service schedule, Schedule WEE-12.

In response to DIV 1-11, Mr. Edge acknowledged that he inadvertently included these financing costs both in the IFR claim as well as in the debt service schedule. Accordingly, my first adjustment is to reduce the IRF claim to eliminate $50,000 in borrowing costs on this initial $1 million. This adjustment reduces WWD's requested IFR funding to $2,150,000.

Q. Didn't Mr. Edge indicate in response to DIV 1-11 that eliminating the debt service payment included in the IFR will simply make more funds available for IFR projects?

A. Yes, he did. However, as addressed below, I have concerns about the overall level of funding being requested for the IFR. In addition, the Company's claim represents a very large rate increase for the customers of WWD. It is unreasonable to include an inflated IFR claim in the Company's revenue requirement under the assumption that WWD will find something on which to spend these funds. Instead, we should be evaluating what is the lowest reasonable amount of IFR funding required in order for WWD to meet its requirement to provide safe and adequate water service while recognizing the significant rate burdens being placed on its customers. In making my adjustments, I am attempting to balance the needs of WWD customers for good, reliable water service with the objective of having reasonable utility rates. Since the debt service costs have been included twice in WWD's filing, there is no reason why this oversight should not be corrected by reducing WWD's IFR claim to eliminate the double-counting of this debt service cost.

Q. Please explain your second recommended adjustment to the Company's IFR claim.

A. Reducing the Company's claim to eliminate the $50,000 included for debt service costs results in a revised IFR claim of $2,150,000, an increase of $395,000 over WWD's current funding level of $1,755,000. I am recommending that the Commission increase WWD's IFR funding to $1,952,500, which is the midpoint between the current funding level and WWD's claim, adjusted to eliminate the previously-discussed debt service. My recommendation will mitigate WWD's requested rate increase. In addition, my recommendation is generous relative to IFR estimates made by WWD's own consultants, as discussed below.

Q. What has been WWD's actual experience with regard to IFR expenditures over the

past few years?

A. According to its Restricted Account Activity Reports, WWD has made the following IFR expenditures:

Period	IFR Expenditures
July 1, 2006-Dec. 31, 2006	$163,913
Fiscal Year 2006	$1,369,743
Fiscal Year 2005	$1,248,021

Therefore, an increase in spending to $2.2 million would constitute a significant increase over the IFR that has been managed heretofore by WWD. In addition, according to a memo from Paul Eisenhardt to WWD, which was provided in response to DIV 1-10, one of the causes of the rate increases projected for the next five years is "[e]xcessive reliance on 'Pay Go' capital rather than additional revenue bond financing to spread the costs over a 20-30 year time horizon." I am not sure what the Eisenhardt Group means by using the word "excessive". However, in the accompanying July 2006 Eisenhardt Report, the Eisenhardt Group lays out four financial scenarios for WWD. Scenario 1 is basically business as usual or the base case. Scenario 2 is similar but assumes increased sales to the Town of North Smithfield. Scenario 3 presents " a combination of rate increases and cost cutbacks to generate roughly breakeven operating margins and maintain reasonable levels of cash reserves." Scenario 4 includes construction of the new treatment plant, the alternative that was presented in this case by WWD. In that scenario, IFR spending is reduced to $1.1 million in fiscal year 2007.[5] The Eisenhardt Report projects IFR spending of $1.72 million in fiscal year 2008, $1.77 million in fiscal year in 2009, $1.31 million in fiscal year 2010, and $1.35 million in fiscal year 2011. These projections include distribution system projects of $1.24 million to $1.35 million. The remaining costs for fiscal years 2008 and 2009 are IFR costs related to the existing treatment plant. Once the new treatment plant in completed, the Eisenhardt Report projects that these costs will no longer be incurred.

Q. What is the significance of the IFR costs reflected in the Eisenhardt Report?

A. It is important to keep in mind that this report is the basis for the Company's financial projections supporting the new treatment plant. In those reports, the Company's financial advisors are projecting IFR spending that is significantly less than the $2.2 million being requested by WWD. As noted above, the bulk of WWD's requested IFR funding relates to distributions system spending. Mr. Edge's IFR schedule includes $8,357,100 for distribution system improvements over 4 years. However, Mr. Edge's projections appear aggressive, particularly when one considers the amounts that have been spent historically on the IFR, the Eisenhardt Report estimates, and the fact that WWD will be in the process of constructing a new treatment plant over the next several years, which is sure to require a significant amount of WWD resources. Therefore, my recommendation to approve only 50% of the requested increase in IFR funding is very reasonable. My

5 While the text of the report indicates fiscal year 2007 IFR spending of $1.1 million, the accompanying schedules

recommendation is shown in Schedule ACC-7.

H. <u>Operating Reserve Allowance</u>

Q. What is an operating reserve allowance?

A. WWD is not an investor-owned utility. Accordingly, it is regulated on a cash flow basis. WWD's revenue requirement does not include any return on rate base**,** which is traditionally included in the revenue requirement of an investor-owned utility. However, the Commission has traditionally allowed municipal water utilities to collect an operating reserve allowance of 1.5% of expenses in order to mitigate cash flow problems, and to provide for unforeseen expenditures or reduced revenue. WWD has included an operating reserve of 1.5% of total costs in its revenue requirement claim.

Q. What are you recommending in this case?

A. I recommend that the Commission continue to permit WWD to recover a 1.5% operating reserve allowance, but I recommend that this percentage be applied only to WWD's operating and maintenance expenses. These costs are subject to greater variation and uncertainty than the capital costs included in WWD's filing. Accordingly, at Schedule ACC-8, I have made an adjustment to apply the 1.5% operating revenue allowance to the pro forma level of operating and maintenance expenses that I have found to be reasonable. In developing my adjustment, I have applied the 1.5% to all costs except for

show spending of only $877,715, which includes $500,000 for the distribution system and $377,715 for the water the renewal and replacement fund, the IFR, and the debt service requirement. It should be noted that I have included both the rate case reserve and the chemical reserve in the amounts to which the 1.5% is applied. Although the annual funding amounts associated with these reserves do not vary from year-to-year, the actual underlying costs can vary as can disbursements from the reserves, and are, to some degree, outside of the Company's control. Therefore, I believe that it is reasonable to include the rate case reserve and the chemical reserve funds in the costs that are subject to the operating reserve allowance. Disbursements from the remaining reserve accounts do not fluctuate significantly and/or are within WWD's control and therefore funding for the renewal and replacement reserve, IFR, and debt service reserve should not be included in the costs subject to the operating reserve allowance.

Q. Is your recommendation consistent with the Commission's decision in WWD's last base rate case?

A. Yes, it is. In that case, the Commission approved an operating allowance of 1.5% of expenses, but excluded the renewal and replacement reserve, IFR, and debt service costs from the amounts subject to the 1.5% reserve allowance.

Q. Has WWD acknowledged that its operating reserve is overstated?

A. Yes, it has. In response to COMM 1-22, Mr. Edge acknowledged that WWD's operating

plant.

reserve claim is inconsistent with the methodology approved in the Company's last case. Accordingly, he stated that he would "use the Commission approved approach" in his Rebuttal Testimony and "make the necessary adjustments accordingly." Therefore, I do not believe that there is currently any disagreement between the Division and WWD regarding the methodology for determining WWD's operating reserve allowance.

I. Other Issues

Q. Are there any other issues that you would like to bring to bring to the Commission's attention in this case?

A. Yes, there is one additional issue that I would like to bring to the Commission's attention. In the last case, WWD requested funding for 33 positions. In that case, the Division recommended that the Commission approve funding for only 32 positions, since that was the average number of positions filled during the test year. The Commission rejected my recommendation, and instead approved funding for 33 employees. In this case, WWD has included funding for 33.5 employees.

As shown in the response to DIV 1-26, WWD has not actually had 33 employees since fiscal year 2005. WWD had, on average, 31 employees during the test year, including one temporary employee. Given the fact that the Commission authorized funding for 33 employees in WWD's last base rate case, I have not reflected any adjustment to the Company's claim in my revenue requirement recommendation. However, since WWD has continued to operate successfully with less than 33 employees, the Commission may want to eliminate funding for at least one unfilled position, along with associated benefits and payroll taxes. The Division would not be opposed to such an action on the part of the Commission. If the Commission decides to eliminate one (or more) unfilled positions, then the Division recommends that an average annual salary be used to determine the amount to be excluded from WWD's revenue requirement claim, rather than eliminating the payroll costs for one (or more) specific positions. This recommendation provides WWD with flexibility to fill (or not fill) whichever positions it believes are actually necessary to the provision of safe and reliable water utility service.

Q. Have you obtained any updated information with regard to WWD's personnel costs?

A. Yes, I have. In data request DIV 2-8, I asked WWD to update its permanent services costs for the twelve months ending December 31, 2006. The Company reported actual costs of $1,358,615, which included not only direct permanent services costs (Account 51110) but related temporary labor, overtime pay, longevity pay, and other personnel-related costs. WWD has requested total rate year personnel costs of $1,533,067 in its claim, which represents an increase of 12.8% over the actual personnel costs incurred for the twelve months ending December 31, 2006. Even after one makes adjustments for the upgrade study increases granted in the last half of 2006, and adjusts for a projected rate year increase of 3%, there is still a significant variation between the most recent actual annualized costs and the Company's claim of $1,533,067. Therefore, the Commission may decide that it wants to reconsider its decision to include personnel costs for 33 employees, and instead base WWD's personnel costs on current personnel levels at the utility.

V. SUMMARY

Q. What is the result of the adjustments that you are recommending in this case?

A. My adjustments reduce WWD's revenue requirement from the $8,623,437 included in Mr. Edge's testimony to $8,175,391. Based on my pro forma operating revenue at present rates of $7,266,691, I recommend a rate increase of $908,700 or 12.51%, as shown in Schedule ACC-1.

To summarize, I am recommending the following adjustments to WWD's claim:

Operating Revenue	$363,318
Light and Power	16,537
Health Insurance	51,157
Engineering Services	60,084
Rate Case Costs	8,000
IFR Program	247,500
Operating Reserve Allowance	64,768
Total Adjustments	$811,364

Q. Does this complete your testimony?

A. Yes, it does.

Schedule ACC-1

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

REVENUE REQUIREMENT SUMMARY

	WWD Claim (A)	Recommended Adjustments		Recommended Position
1. Personnel Costs	$1,533,067	$0		$1,533,067
2. Maintenance and Servicing	980,391	(16,537)	(B)	963,854
3. Operating Supplies	150,306	0		150,306
4. General Charges	1,272,801	(111,241)	(C)	1,161,560
5. Restricted Account Expenses	4,686,872	(320,268)	(D)	4,366,604
6. Less Miscellaneous Income	0			0
7. Total Net Revenue Requirements	$8,623,437	($448,046)		$8,175,391
8. Operating Revenues @ Present Rates	6,903,373	363,318	(E)	7,266,691
9. Revenue Deficiency	**$1,720,064**	**($811,363)**		**$908,701**
10. Increase over Present Rates	**24.92%**			**12.51%**

Sources:
(A) Schedules WEE-1 and WEE-3.
(B) Schedule ACC-3.
(C) Schedules ACC-4 and ACC-5.
(D) Schedules ACC-6, ACC-7, and ACC-8.
(E) Schedule ACC-2.

Schedule ACC-2

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

OPERATING REVENUE

1.	Two Year Average (Ccfs)	1,713,789	(A)
2.	Company Claim (Ccfs)	1,588,029	(B)
3.	Recommended Adjustment (Ccfs)	125,760	
4.	Current Retail Rate / Ccf	$3.24	(C)
5.	Gross Revenue Adjustment	$407,463	
6.	Incremental Power and Chemical Costs	(44,146)	(E)
7.	Net Revenue Adjustment	**$363,318**	

Sources:
(A) Derived from response to DIV 1-17.
(B) Actual test year consumption per response to DIV 1-17.
(C) Current metered consumption rate.
(D) Incremental Costs Based on:

Power Costs Per Company	$269,182
Chemical Costs Per Company	304,800
Power Adjustment	(16,537)
Pro Forma Power & Chemicals	$557,445
Company Claimed Sales (Ccfs)	1,588,029
Incremental Costs Per Ccf	$0.3510

Schedule ACC-3

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

LIGHT AND POWER

1.	Average FCM Rate	$0.0093	(A)
2.	Company FCM Rate	0.0120	(B)
3.	Recommended FCM Adjustment	($0.0027)	
4.	Average RY CNE Settlement	(0.0045)	(C)
5.	Total Adjustment Per Kwh	($0.0072)	
6.	Total Kwhs	2,304,795	(B)
7.	Recommended Adjustment	**($16,537)**	

Sources:
(A) Based on rates per the response to COMM-23.
(B) Schedule WEE-6a.
(C) Reflects credit of $0.009 per kwh per Schedule WEE-6a
for first half of rate year.

Schedule ACC-4

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

HEALTH INSURANCE

1.	Interim Year Claim	$448,743	(A)
2.	Increase Through Rate Year	10.50%	(B)
3.	Pro Forma Increase	$47,118	
4.	Company Claim	98,275	(A)
5.	Recommended Adjustment	**($51,157)**	

Sources:
(A) Exhibit WEE-8.
(B) Derived from Exhibit DGB-2 and Exhibit WEE-8.

Schedule ACC-5

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

ENGINEERING SERVICES

1.	Company Claimed Adjustment	$60,084	(A)
2.	Pro Forma Adjustment	**($60,084)**	

Sources:
(A) Schedule WEE-3.

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

RATE CASE COSTS

1.	Recommended Annual Funding	$73,364	(A)
2.	Company Claim	81,364	(B)
3.	Recommended Adjustment	**($8,000)**	

Sources:
(A) Reflects estimated costs of $146,728 amortized over two years.
(B) Schedule WEE-11.

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

INFRASTRUCTURE REPLACEMENT

1.	Recommended Funding Level	$1,952,500	(A)
2.	Company Claim	2,200,000	(B)
3.	Recommended Adjustment	**($247,500)**	

Sources:
(A) Recommendation of Ms. Crane.
(B) Schedule WEE-10.

Schedule ACC-8

WOONSOCKET WATER DEPARTMENT

RATE YEAR ENDING JUNE 30, 2008

OPERATING RESERVE

1.	Pro Forma Operating Expenses	$3,808,787	(A)
2.	Chemicals Reserve	296,000	(B)
3.	Rate Case Reserve	73,364	(C)
4.	Total Pro Forma Costs	$4,178,151	
5.	Operating Reserve Ratio	1.50%	(D)
6.	Pro Forma Operating Reserve	$62,672	
7.	Company Claim	127,440	(D)
8.	Recommended Adjustment	**($64,768)**	

Sources:
(A) Schedule ACC-1, lines
(B) Schedule WEE-9.
(C) Schedule ACC-6.
(D) Schedule WEE-3.